

## Message Text

CONFIDENTIAL

PAGE 01 TOKYO 10626 01 OF 02 151128Z

11

ACTION EB-04

INFO OCT-01 SS-04 NSC-04 NSCE-00 TRSE-00 FRB-03 INR-01

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P 151050Z AUG 74

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC PRIORITY 3947

C O N F I D E N T I A L SECTION 1 OF 2 TOKYO 10626

PASS TREASURY OPENING OF BUSINESS FOR COOPER AND CROSS

LIMDIS GREENBACK

E.O. 11652: GDS

TAGS: EFIN, JA

SUBJECT: ASSESSMENT OF WEAKENING YEN/DOLLAR RATE

REF: A. TOKYO 10415; B. TOKYO 7208

SUMMARY: EMBASSY ENABLE TO UNCOVER CONCRETE EVIDENCE THAT GOJ INTENTIONALLY DEPRECIATED YEN. ON OTHER HAND, BASED ON ALL EVIDENCE AVAILABLE, IT SEEMS CLEAR THAT GOJ DESIRED LOWER YEN VALUE AND PERMITTED MARKET DEPRECIATION. FOLLOWING IS FINATT ASSESSMENT OF FACTORS RELEVANT IN REACHING THAT CONCLUSION WITH EMBASSY COMMENTS AT END . END SUMMARY.

### 1. B/P DEVELOPMENTS

STRENGTH OR WEAKNESS OF YEN VS. DOLLAR AND OTHER OECD CURRENCIES DURING 1974 IN NO WAY CORRELATES POSITIVELY WITH JAPAN'S B/P STRENGTH OR WEAKNESS. IN FACT, DURING CERTAIN PERIODS NEGATIVE CORRELATION CAN BE OBSERVED. STRENGTHENING OF YEN FROM MID-JAN RATE OF 300/DOLLAR TO 276-278/DOLLAR RANGE PREVAILING RATE MARCH TO MID-MAY COINCIDES WITH PERIOD OF LARGEST B/P DEFICITS ON TRADE AND CURRENT ACCOUNT (ON BOTH SEASONALLY UNADJUSTED AND ADJUSTED BASES) AND ON

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PAGE 02 TOKYO 10626 01 OF 02 151128Z

BASIC AND OVERALL BALANCES. STRENGTHENING ALSO COINCIDES

WITH \$921 MIL RISE IN OFFICIAL RESERVES (WHICH IN PART REPRESENTS ADDED FOREX DEMAND AS MOF WITHDREW DEPOSITS FROM JAPANESE BANKS). FROM MID-MAY TO END OF JUNE YEN EASED FROM 278/DOLLAR TO 284/DOLLAR AT A TIME WHEN THERE WERE CLEAR SIGNS OF TRADE IMPROVEMENT, AS HIGHER OIL COSTS WERE VIRTUALLY OFFSET BY DRAMATIC RISE IN NON-OIL MERCHANDISE SURPLUS. FURTHER RATE DETERIORATION IN JULY BRINGING IT BELOW 300/DOLLAR LEVEL BY EARLY AUGUST OCCURRED IN MONTH WHEN OVERALL B/P BALANCE IMPROVED \$1 BIL AND \$100 MIL DEFICIT WAS SMALLEST IN 16 MONTHS. JULY CURRENT ACCOUNT DEFICIT (SEASONALLY UNADJUSTED) WAS ALSO SMALLEST YET THIS YEAR.

## 2. INFLUENCE OF FOREX CONTROLS

FINATT CONSIDERS YEN RATE MOVEMENTS AS VERY MUCH INFLUENCED BY CAPITAL CONTROLS WHICH HAVE TIGHTLY RESTRICTED INFLOWS OF FOREIGN FUNDS. WHILE THESE HAVE BEEN PROGRESSIVELY LOOSENED THIS YEAR (SEE TOKYO 9914, 9062, 4851), NET INFLOWS OF FUNDS HAVE NOT BEEN FULLY ADEQUATE TO PREVENT DOWNWARD RATE PRESSURE GIVEN CURRENT ACCOUNT AND CAPITAL DEMANDS (WHICH INCLUDE NET REPAYMENTS OF MOF DEPOSITS BY BANKS). POLICY CHANGE IN JULY AND AUGUST OF REDEPOSITING MOF FUNDS WITH BANKS TO MEET FOREX DEMANDS EVIDENTLY NOT SUFFICIENT TO PREVENT CONTINUED DOWNWARD RATE PRESSURE. IN FINATT VIEW, MOF DELAY IN LOOSENING CONTROLS AND MANIPULATION OF MOF DEPOSITS MUST BE CONSIDERED AN IMPORTANT FACTOR IN EXPLAINING DOWNWARD RATE PRESSURES. (FOR VIEWS ON SIMILAR PERIOD IN LATE 1973 SEE TOKYO LIMDIS GREENBACKS 14820 AND 14450.) FINATT MUST CONCLUDE THAT IMPACT OF MOF POLICY ON CONTROLS AND HIDDEN RESERVES WAS INTENTIONAL AND THAT RATE MOVEMENTS WERE CONSIDERED "DESIRABLE" BY MOF. AS CONTROLS WERE CAUTIOUSLY LOOSENED THIS SPRING, U.S. BANKS REPORTED LITTLE ARBITRAGE INCENTIVE FOR INFLOW OF FUNDS. IN ADDITION, TERMS AND CONDITIONS DEMANDED ON IMPACT LOANS CONSIDERED LESS ATTRACTIVE THAN IN PAST AND IN COMPARISON WITH USE OF FUNDS ELSEWHERE OUTSIDE OF JAPAN. DESPITE RECENT ADDITIONAL \$140 MIL OF IMPACT LOANS FOR AUGUST AND SEPTEMBER U.S. BANKERS REPORT LITTLE INTEREST IN MAKING LOANS WITHOUT JAPANESE BANK GUARANTEE OR COLLATERAL TERMS NOW BEING DEMANDED BY

CONFIDENTIAL

PAGE 03 TOKYO 10626 01 OF 02 151128Z

JAPANESE BORROWERS (E.G. SHIPBUILDERS). CONDITIONS IMPOSED ON ADDITIONAL \$500 MIL SWAP LINE ALSO PROVIDE LITTLE INCENTIVE FOR U.S. BRANCHES TO BRING IN FUNDS. THUS, DESPITE APPARENT GREAT ANXIETY AND CONCERN REPORTED IN JAPANESE PRESS AND FINANCIAL CIRCLES OF ADEQUATE SHORT-TERM BORROWING IN EURO AND U.S. MARKETS TO MEET B/P NEEDS, MOF STILL MOVING VERY CAUTIOUSLY AND IMPOSING CONDITIONS ON ADDED INFLOWS OF FOREIGN FUNDS. CONTROLS ON EXPORT OF CAPITAL EVIDENTLY NOT NEARLY AS

TIGHT AS IN PAST PERIODS OF JAPANESE B/P DEFICIT.

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PAGE 01 TOKYO 10626 02 OF 02 151459Z

44

ACTION EB-04

INFO OCT-01 SS-04 NSC-04 NSCE-00 TRSE-00 FRB-03 ISO-00

DRC-01 RSC-01 INR-01 INRE-00 CIEP-01 CIAE-00 /020 W

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P 151050Z AUG 74

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC PRIORITY 3948

C O N F I D E N T I A L SECTION 2 OF 2 TOKYO 10626

LIMDIS GREENBACK

PASS TREASURY OPENING OF BUSINESS FOR COOPER AND CROSS

3. JAPANESE VIEWS ON B/P DEFICIT AND APPROPRIATE FOREX RATE

FOLLOWING CALMER COREX MARKET BEHAVIOR IN MAY THIS YEAR, SEVERAL JAPANESE BUSINESSMEN STILL CONSIDERED YEN TOO HIGH, BELIEVING A RATE OF 300/DOLLAR MUCH MORE APPROPRIATE TO JAPAN'S AGGRAVATED B/P SITUATION. AS RECENTLY AS A WEEK AGO FORMER VMIN INAMURA TOLD FINATT THAT IN HIS VIEW 300/DOLLAR WAS A MORE REALISTIC RATE FOR JAPAN. RECENTLY RELEASED EPA ECONOMIC WHITE PAPER STATES THAT "JAPAN'S B/P TURNED INTO DEFICIT AT ABOUT THE SAME TIME AS THE YEN WAS FLOATED" IN FEB 1973. AS A RESULT OF THAT EXCHANGE RATE ADJUSTMENT, "THE COMPETITIVENESS OF LABOR-INTENSIVE LIGHT INDUSTRY PRODUCTS WAS PARTICULARLY IMPAIRED. IMPORTS OF MANUFACTURES PRODUCTS INCREASED SUBSTANTIAL" AFTER COMPLAINING THAT JAPAN'S B/P WAS ADVERSELY INFLUENCED BY SUBSTANTIAL EXCHANGE RATE CHANGES AND RISES OF PRIMARY PRODUCT PRICES, THE WHITE PAPER GOES ON TO REPORT THAT NEVERTHELESS JAPAN'S SHARE IN WORLD TRADE OF IRON AND STEEL, CHEMICALS AND MACHINERY PRODUCTS HAS INCREASED REMARKABLY IN RECENT YEARS. MORE RAPID INFLATION IN JAPAN THAN IN OTHER COUNTRIES IS OFTEN CITED AS ANOTHER FACTOR JUSTIFYING THE RECENT DEPRECIATION OF THE YEN. EVEN BOJ VICE GOVERNOR KONO CONSIDERS THE

BALANCE OF PAYMENTS DEFICIT AS JAPAN'S SINGLE MOST  
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PAGE 02 TOKYO 10626 02 OF 02 151459Z

IMPORTANT ECONOMIC PROBLEM.

#### 4. TRADE OUTLOOK

REVISED B/P PROJECTION AND ANALYSIS RECENT TRADE DEVELOP-  
MENTS BEING TRANSMITTED SEPTEL. IN GENERAL, PREVIOUS  
FINATT FORECAST IN JULY 12 MEMO NOT OUT OF LINE  
WITH PRIVATE FORECASTS IN JAPAN. HOWEVER, PRESENT  
TIGHT MONEY/FISCAL POLICY WILL EVIDENTLY REMAIN UNCHANGED  
FOR SOME MONTHS TO COME. LIKELY RESULT IS WEAKER IMPORT  
DEMAND AND STRONGER TRADE AND CURRENT ACCOUNT POSITION.  
WHETHER THIS WOULD LEAD TO STRENGTHENING OF YEN IN PERIOD  
AHEAD DEPENDS ON MOF FOREX CONTROL POLICIES.

#### 5. COMMENTS

A. EPA AND MOF APPEAR TO RELATE LAST YEAR'S TRADE  
DETERIORATION PURELY TO THE DOLLAR DEVALUATION AND YEN  
FLOAT WITHOUT RECOGNIZING THE OVERHEATED CONDITION OF  
THE JAPANESE ECONOMY, THE EXAGGERATED PURCHASES OF RAW  
MATERIALS AND THE IMPACT OF THAT ON WORLD COMMODITY  
PRICES AND, THEREFORE, IMPORT PRICE LEVELS. THE IMF  
STAFF'S APPRAISAL AT YEAR-END (SEE SM/73/287, P. 13)  
THAT "WHILE THE EFFECTS OF THESE FACTORS MAY NOT DIS-  
APPEAR EARLY IN 1974, IT WOULD CAUSE UNNECESSARY  
INSTABILITY IF THE EXCHANGE RATE WAS ADJUSTED WITHOUT  
TAKING ACCOUNT OF THE SPECIAL CIRCUMSTANCES OF 1973"  
HAS FALLEN ON DEAF EARS. MOREOVER, THE ADVERSE IMPACT  
ON DOMESTIC ANTI-INFLATIONARY POLICY OF THE YEN  
DEPRECIATION IS APPARENTLY BEING IGNORED BECAUSE OF  
BALANCE OF PAYMENTS PRIORITIES. FINALLY, THERE IS LITTLE  
RECOGNITION THAT EFFORTS TO INCREASE EXPORTS AT A TIME  
WHEN OTHER COUNTRIES ARE MOVING INTO RECESSION MAY WELL  
CREATE FRICTIONS, ALTHOUGH THERE IS CONCERN THT RECESSIONS  
ABROAD WILL INCREASE PROBLEMS FOR DOMESTIC PRODUCERS NOW  
FACING A PROLONGED PERIOD OF SLACK DOMESTIC DEMAND.

B. EMBASSY UNCERTAIN WHETHER WASHINGTON CONSIDERS INTERIM  
GUIDELINES FOR MANAGEMENT OF FLOATING CURRENCIES ADOPTED  
BY C-20 MINISTERS JUNE 13 SUPERCEDE BILATERAL U.S.-JAPAN  
UNDERSTANDING AT TIME OF SMITHSONIAN AND SECOND DOLLAR  
CONFIDENTIAL

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PAGE 03 TOKYO 10626 02 OF 02 151459Z

DEVALUATION. IMPRESSION WE HAVE HERE IS THAT JAPAN CONSIDERS JUNE 13 GUIDELINES AS ONLY PRESENTLY APPLICABLE UNDERSTANDING. MOF CONSIDERS IT IS OPEATING CONSISTENTLY WITHIN THOSE GUIDELINES EVEN THOUGH WE ARE UNAWARE OF ANY ATTEMPT TO CONSULT U.S. OR OTHERS ABOUT YEN RATE MOVEMENTS DESPITE EXPLICIT RECOGNITION IN C-20 OUTLINE OF REFORM, PART I, THAT "EXCHANGE RATES WILL CONTINUE TO BE A MATTER FOR INTERNATIONAL CONCERN AND CONSULTATION." THERE SEEMS TO BE NO PUBLIC RECOGNITION THAT THE YEN HAS NOW DEPRECIATED BELOW THE SMITHSONIAN RATE ON A TRADE-WEIGHTED BASIS. GUIDELINES ON U.S. INTERPRETATION OF JUNE 13 GUIDELINES IN RELATION TO SMITHSONIAN AND SECOND DOLLAR DEVALUATION WOULD BE APPRECIATED.  
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